No. 21,169

IN THE

United States Court of Appeals

For the Ninth Circuit

A. Bates Butler, Trustee of Construction Materials Co.,

Appellant,

vs.

Pacific National Insurance Company, aka Transamerica Insurance Company, and State of Arizona, David H. Campbell, Superintendent, Arizona Highway Department,

Appellees.

On Appeal from the United States District Court for the District of Arizona

OPENING BRIEF FOR APPELLANT

Hirsch, Van Slyke & Ollason,
By Gerald B. Hirsch,
182 North Court, Tucson, Arizona,
Attorneys for Appellant.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

Subject Index

Table of Authorities Cited

No. 21,169

IN THE

United States Court of Appeals

For the Ninth Circuit

A. Bates Butler, Trustee of Construction Materials Co.,

Appellant,

vs.

Pacific National Insurance Company, aka Transamerica Insurance Company, and State of Arizona, David H. Campbell, Superintendent, Arizona Highway Department,

Appellees.

On Appeal from the United States District Court for the District of Arizona

OPENING BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from a judgment entered on the 6th day of April, 1966, by the United States District Court for the District of Arizona. This appeal is brought under the jurisdiction established in Section 24 of the Bankruptcy Act, 11 U.S.C.A., Section 47.

INTRODUCTION

For the sake of clarity, A. Bates Butler, Trustee in Bankruptcy of Construction Materials Company, bankrupt, appellant, shall hereafter be referred to as "trustee". Construction Materials Company, bankrupt, will hereafter be referred to as "bankrupt". Transamerica Insurance Company shall hereafter be referred to as "appellee".

The appellant, after thorough research, has come to the conclusion that the only specification of error relied upon is as contained in this brief, and therefore, this brief will contain no questions or argument as to other specifications of errors previously filed herein.

STATEMENT OF THE CASE

The appellant in this case is the duly appointed and acting trustee in bankruptcy of the bankrupt. A Chapter XI Bankruptcy Proceeding (voluntary) was filed on November 22, 1963. At that time, the bankrupt was doing certain road work for the State of Arizona under a contract designated as U.S. 345 (4) East Broadway Road, Tucson (see appellant's Exhibit No. 2). Upon undertaking the contract, the bankrupt had furnished the State of Arizona a bond for performance of contract written by Pacific National Insurance Company as surety. (It is stipulated that Pacific National Insurance Company is the predecessor of appellee). The bankrupt commenced work in June of 1963 and at no time did the work cease

until final completion of the contract in November of 1963. The bankrupt entered into a written contract with Ashton Construction Co. (see appellant's Exhibit No. 4), whereby Ashton agreed to complete the project as a subcontractor of the bankrupt. Ashton was to bill the bankrupt for its work and the bankrupt was thereupon to pay Ashton. The State of Arizona was not a party to this contract and neither was appellee. There was no assignment of funds from the bankrupt to Ashton of any funds held by the State of Arizona. The Ashton Company finished its work during the month of December, 1963. At the time the work was completed the State of Arizona had received actual notice that the appellant had been appointed as receiver for the bankrupt. The Ashton Company billed the bankrupt for the sum of $33,238.60 on the subject project. The State of Arizona after deducting a charge for late completion still had in its possession the sum of $21,557.27 as funds due the contractor on said job. In March of 1964 Ashton in writing (see appellant's Exhibit No. 7), requested information from the State of Arizona pertaining to the performance bond posted by the bankrupt. After extended negotiations with appellee, Ashton settled its claim for $31,000.00 which was paid by appellee to Ashton, and Ashton assigned its claim to the funds held by the State of Arizona to the appellee on May 13, 1964 (see appellant's Exhibit No. 8). The State of Arizona made no claim to the money it held and interpleaded same with the District Court hearing the subject case to be held until final decision of the case.

SPECIFICATION OF ERROR RELIED UPON

Since appellee had no agreement with the bankrupt pertaining to an assignment of funds held by the State of Arizona, it cannot by its own act become a secured creditor with rights superior to other general or unsecured creditors of the bankrupt.

QUESTION PRESENTED

Is the appellee barred from receiving the money held by the State of Arizona when it did not have any assignment agreement with the bankrupt whereby the bankrupt assigned to the funds held for the bankrupt by the State of Arizona?

ARGUMENT

The law is well settled and to the contrary of the appellee's position that in the absence of a specific provision establishing it in the contract the surety has no direct right to funds held by the State, and neither does the sub-contractor or materialman. *Adamson v. Paonessa,* 179 Pac. 880.

The first point that must be established in order to decide who is entitled to the funds is what is the law of the State of Arizona on this point. The District Court will apply the law of the State of Arizona since the contract arose here and was completed here between residents of this State.

The law of Arizona pertaining to lien rights of contractors, sub-contractors and materialmen is set forth in Section 33-981, Arizona Revised Statutes, as amended:

> "Sec. 33-981. Lien for labor or materials used in construction, alteration or repair of structures.
>
> A. Every person who labors or furnishes materials, machinery, fixtures or tools in the construction, alteration or repair of any building, or other structure or improvement whatever, shall have a lien thereon for the work or labor done or materials, machinery, fixtures or tools furnished, whether the work was done or articles furnished at the instance of the owner of the building, structure or improvement, or his agent.
>
> B. Every contractor, sub-contractor, architect, builder or other person having charge or control of the construction, alteration or repair, either wholly or in part, of any building, structure or improvement, is the agent of the owner for the purposes of this article, and the owner shall be liable for the reasonable value of labor or materials furnished to his agent."

This law as it pertains to public contracts was the subject of the case of *Webb v. Crane Co.*, an Arizona case reported in 52 Ariz. 299, 80 P.2d 698. In that case, Webb entered into a contract with the Arizona State Teachers College at Flagstaff to do some construction work. Webb submitted two bonds in conjunction with the contract, one a performance bond and one a labor bond. Subsequently, a supplier who

was not paid by a sub-contractor who did the plumbing work, brought suit against Webb and his surety on the theory that the bond posted was a third party bond. The Court held for the Plaintiff and in the decision went into the question of lien rights in Arizona so far as public construction work was concerned. The Court quoted from the cases of *Storey & Fawcett v. Nampa and Meridian Serv. Dist.,* 32 Idaho 713, 187 Pac. 946, and *Hutchinson v. Krueger,* 34 Okla. 23, 124 Pac. 591 to the effect,

> "The general rule, supported not only by reason but by the overwhelming weight of authority, is that a mechanic's lien does not attach to public property unless expressly provided by statute, since such lien would be contrary to public policy and also incapable of enforcement."

Webb specifically took exception to this interpretation and said it was inapplicable in Arizona for the reason that the lien law referred to "any building". The Court held that that expression did not provide specifically and expressly that the mechanic's lien law shall apply to public buildings or property, but did so only inferentially, if at all, and then quoted from the case of *Moss Iron Works v. Jackson County Court,* 89 W. Va. 367, 109 S.E. 343, as follows:

> "Inclusion by reference or interpretation is not sufficient, when the right to perfect a mechanic's lien or materialman's lien upon public buildings is involved. To warrant the creation and enforcement of such a lien against public buildings, the authority must be specific, positive, and unmistakable in its meaning and terms. They must leave open no room for construction or interpre-

> tation. . . To subject property owned and used by the public for the transaction of public business to the mechanic's liens, the authorization must, according to the general, indeed the most invariable rule, be unequivocal, not inferential."

In the *Webb* case the Court established the law of the State of Arizona to be unequivocally "that public buildings used for public purposes are not subject to a mechanic's lien law unless the Legislature has expressly made them so".

The Legislature of the State of Arizona has not seen fit to subject contracts for public works to the mechanic's lien laws. It is therefore seen that the laborers or materialmen whom the appellee paid had no lien rights against the State. Any rights that the appellee got by subrogation are limited to the rights that they, the creditors, had. Just what rights did they have? They had no right against the State since the contract between the State and Construction Materials Company provided for no such right. There was no agreement whatsoever between the State and the appellee giving the appellee a right to retained funds in the event the appellee paid any claims under its bond.

In the case at hand no written application was made for the bond submitted to the State of Arizona and no verification or check of the financial standing of Construction Materials Company was made (see deposition of George Leacher, p. 14, line 13, through p. 17, line 26). There was no indemnity agreement between Construction Materials Co. and the appellee and one

had never existed. There is in fact no basis for the appellant's claim other than the Agreement of November, 1962, which was entered into between Construction Materials Co. and an entirely different and distinct insurance company. It is stretching the imagination to hope that such an indemnity agreement could give this appellee any rights whatsoever. There was and is no indemnity agreement in existence which would give the appellee in this case any right to retained funds held by the State of Arizona. The appellee knew prior to the time it paid out any funds that the State of Arizona would not pay any monies to them (see Exhibit No. 15), and yet with this knowledge, paid to Ashton the sum of $31,000.00 (see Depo. George Leacher, p. 8, line 15, through p. 9, line 18).

It is appellant's position that payment by a surety to sub-contractor for a claim filed by the sub-contractor gives the surety just whatever rights the sub-contractor had against the State (or to the retained funds), and no greater rights. This is the law and has been settled in the case of *Adamson v. Paonessa*, a California case reported in 179 Pac. 880. This case is almost exactly similar to the case at hand. Paonessa had entered into a contract to do certain work for the City of Colton. He filed a surety bond (for the payment of claims for materials, labor, etc.). National Surety Company was the surety on the bond. Paonessa had made a written application for the bond. (In the case at hand we have no such written application.) A portion of the application reads as follows:

> "All payments specified in the above-mentioned contract (i.e. the contract with the City of Colton for doing the work) to be withheld by the obligee until the completion of the work shall, as soon as the work is completed, be paid to the Company (the surety company) and this covenant shall operate as an assignment thereof, and the residue, if any, after reimbursing the company as aforesaid, be paid to the applicant after all liability of the Company has ceased to exist under said bond."

No notice of this assignment (if it was an assignment), was given to the City. (In our case no notice of the indemnity agreement in the name of another insurance company was given to the State until approximately one week before final completion of the job and until the day that Construction Materials Co. had filed a petition for relief under Chapter XI of the Bankruptcy Act.) While the work was in progress another Defendant, Lloyd, advanced funds to Paonessa and took a written assignment of all his rights under the contract and filed the assignment with the City Clerk. When the job was completed the City recognized the assignment to Lloyd. The surety then demanded the money (warrants) on the ground that they held an assignment by virtue of the bond application and the fact that they were called upon to pay approximately $10,000.00 for material and labor furnished which Paonessa had not paid. Judgment was entered against the surety company when then appealed and advanced two grounds for the appeal. Both of the grounds advanced are the grounds that

the appellee in this case suggests as the basis for its claim:

1. That by virtue of its payment as surety for Paonessa of claims against Paonessa for labor and material furnished, it acquired by subrogation an equitable lien upon any monies due under the contract superior to an assignment or other disposition that Paonessa might have made, and

2. That by virtue of the application for the bond, he, Paonessa, had assigned to the surety his right to the money (warrants) to become due him under the contract with the City and this assignment being prior in time to the assignments to Lloyd, is prior in right.

In answer to the first point the Court acknowledged that the surety by virtue of paying the claim pursuant to its obligation as surety obtained a subrogation in its favor of any rights which the claimant had whose claims were paid. But it was also true that the subrogation would give no greater rights than this. The Court then attempted to establish what rights these claimants would have had and decided that the claimants would have had no rights to the funds (warrants). The Court then differentiated between that case and *Prairie State National Bank v. U.S.*, 164 U.S. 227 (relied upon by the appellee in this case to substantiate its position). In explaining the difference the Court said:

> "In those decisions (Prairie State National Bank and others) the facts are essentially the same as

> in this, with the exception that either by statute or by the contract itself a fund was in effect reserved for the benefit of materialmen and laborers whom the contractor might fail to pay."

(In our case neither the contract nor any statute made such a provision.)

> "In other words, the materialmen and laborers had a right as against a certain fund in addition to any recovery against the contractor or his surety. Under such circumstances, if the surety paid their claims, he would be subrogated to their rights against such fund. Such, however, is not the case here, as there is no fund against which the materialmen and laborers have a right."

An examination of the contract in question (Exhibit No. 2), will show that in the case at hand there is no such fund either. Thus we see no statute providing for payment, no contract containing such a payment provision, and no fund out of which to make such payment. The claimant is limited to his right against the surety on the bond and the surety is subrogated to no greater right than the claimant whom he paid had.

The second point on appeal pertained to the notice of assignment given by the surety to the City. They had not given the City notice of the assignment as contained in the application for the bond and the Court held the City was not bound by it since they did have notice of the assignment to Lloyd. In our case there was no written application for the bond, no assignment to the appellee. The appellee is attempting

to become a third party beneficiary of an assignment to a completely autonomous insurance company. The American Insurance Company was a completely independent company authorized in its own name to conduct business in Arizona and was not an agent of the appellee company. American Insurance Company wrote insurance in its own name (see George Leacher deposition, p. 18, lines 11 through 16). It was a distinct corporate entity at the time it obtained the agreement and at the time of the contract between the State and Construction Materials Company in June, 1963. (See deposition of George Leacher, p. 20, lines 16 through 20.)

CONCLUSION

In view of the fact that appellee had notice that the State of Arizona would not pay any sums to them which they were holding without the express written consent of the appellant, and on the further fact that the appellee had no written assignment whatsoever of funds held by the State, it is submitted that appellee acted at its own risk in making payments to Ashton, and cannot by virtue of the fact of having made such payments become a secured creditor with priorities superior to other general creditors of the bankrupt.

It is respectfully submitted that the judgment of the District Court be reversed and that the funds held by the State of Arizona be paid to the appellant herein for disbursement upon order of the Referee

in Bankruptcy for the United States District Court for the District of Arizona.

Dated, Tucson, Arizona,
November 3, 1966.

HIRSCH, VAN SLYKE & OLLASON,
By GERALD B. HIRSCH,
Attorneys for Appellant.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HIRSCH, VAN SLYKE & OLLASON,
By GERALD B. HIRSCH,
Attorneys for Appellant.